92-1158

(4)

Supreme Court, U.S.
FILED
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OFFICE OF THE CLERK

Case No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

WESTERN GAS RESOURCES, INC.,
SUCCESSOR IN INTEREST TO
WESTERN GAS PROCESSORS, LTD.,

Petitioner,

v.

M.K. HEIDI HEITKAMP,
TAX COMMISSIONER OF THE
STATE OF NORTH DAKOTA,

Respondent.

Petition For Writ Of Certiorari
To The North Dakota Supreme Court

APPENDIX TO PETITION FOR WRIT OF CERTIORARI

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125 pp

APPENDIX

TABLE OF CONTENTS

A. Opinion of the North Dakota Supreme Court dated August 19, 1992.

B. Judgment of the North Dakota Supreme Court dated August 19, 1992.

C. Memorandum Decision of the District Court for the South Central Judicial District of the State of North Dakota dated November 14, 1991.

D. Judgment and Notice of Entry of Judgment of the District Court for the South Central Judicial District of the State of North Dakota entered November 25, 1991.

E. Findings of Fact and Conclusions of Law from the Administrative Hearing before the North Dakota State Tax Commissioner dated May 8, 1991.

F. Letter of the State Tax Commissioner dated May 22, 1991, amending, adopting and clarifying the Findings of Fact and Conclusions of Law of the Administrative Hearing Officer.

G. Order of the North Dakota State Tax Commissioner imposing the Oil Extraction Tax dated May 22, 1991.

H. Petition for Rehearing to the North Dakota Supreme Court dated October 1, 1992.

I. Judgment of the Supreme Court of the State of North Dakota dated August 19, 1992.

J. Mandate of the North Dakota Supreme Court dated October 12, 1992.

K. Notice of Determination of the State Tax Commissioner dated October 18, 1985.

L. Amended Administrative Complaint, Objections and Request for Formal Hearing to the North Dakota State Tax Commissioner dated October 24, 1990.

M. Notice of Appeal and Specification of Error to the District Court for the South Central Judicial District of the State of North Dakota dated June 20, 1991.

N. Notice of Appeal to the North Dakota Supreme Court dated November 25, 1991.

O. Transcript of the testimony of Hunter Herron.

P. Transcript of the testimony of Arlon Tussing.

Q. Transcript of the testimony of Duke Ellington.

R. Transcript of the testimony of Bill Sanderson.

Part A

IN THE SUPREME COURT
STATE OF NORTH DAKOTA

Western Gas Resources, Inc.,
successor in interest to
Western Gas Processors, Ltd.,
Plaintiff-Appellant,

vs.

M. K. Heidi Heitkamp,
Tax Commissioner of the
State of North Dakota,
Defendant-Appellee.

Civil No. 920024

Appeal from the District Court for Burleigh County,
South Central Judicial District,
the Honorable William F. Hodny, Judge.

AFFIRMED.

Opinion of the Court By Johnson, Justice.

Gary C. Davenport (argued), of McGloin, Davenport, Severson & Snow, 1600 Stout Street, Suite 1600, Denver, CO 80202-3144, and John W. Morrison (appearance), of Fleck, Mather & Strutz, P.O. Box 2798, Bismarck, ND 58502-2798, for plaintiff and appellant.

Patrick K. Stevens (argued), Assistant Attorney General, State Tax Department, 600 East Boulevard, Bismarck, ND 58505-0599, for defendant and appellee.

JOHNSON, Justice.

Western Gas Resources, Inc. [Western], appeals from a district court judgment affirming a tax assessment by the North Dakota Tax Commissioner [Commissioner] under Chapter 57-51.1, N.D.C.C., the Oil Extraction Tax [OET]. We affirm.

Section 57-51.1-02, N.D.C.C., imposes an " 'oil extraction tax', upon the activity in this state of extracting oil from the earth." For purposes of the OET, Section 57-51.1-01(03) defines "oil" as "petroleum, crude oil, mineral oil, casinghead gasoline, and all liquid hydrocarbons that are recovered from gas on the lease incidental to the production of the gas." The principal issue in this appeal is whether "field condensate" is "oil" as defined by Section 57-51.1-01(3), N.D.C.C. Our analysis of this issue requires a description of "field condensate" and how Western recovers "field condensate" from natural gas.

Western is a gas processing company which owns and operates a natural gas gathering system and a natural gas processing facility in Billings County. Western purchases natural gas from various oil and gas producers and moves the gas through its gathering system to its processing facility at the Teddy Roosevelt Gas Plant [TR Plant]. At the well sites, the producers pump a mixture of oil, gas, and water from wells and separate the mixture into oil, gas, and water phases with a separator or heater treater. The producers dispose of the water, retain the oil, and pipe the gas stream in a vapor form to a "custody transfer meter" where custody and ownership is transferred to Western for movement through its gathering system to its processing facility at the TR Plant.

As the gas stream moves through Western's gathering system, changes in pressure and temperature cause liquid hydrocarbons to condense in the pipeline. The liquid hydrocarbons are called "drips" or "field condensate" and are collected and stored in underground tanks called "drip locations." In addition to the "drip locations," Western also recovers field condensate at field compressor stations, where the gas is compressed in three separate stages to facilitate its movement to the TR Plant. Western sells all the "field condensate" at a crude oil price and puts it in a crude oil pipeline.

After compressing the gas at the compressor stations, Western pipes the gas to an inlet receiver or scrubber at the TR Plant. After the gas passes through the inlet receiver, Western

processes the gas and additional liquids are recovered. The liquids recovered at the TR Plant are referred to as "plant condensate." Field condensate is recovered in Western's gathering system before the inlet receiver at the TR Plant and plant condensate is recovered after the inlet receiver.

On October 18, 1985, the Commissioner assessed an OET against Western for field and plant condensate recovered from January 1981 through December 1983. The Commissioner subsequently abated the assessment for plant condensate and also agreed to Western's valuation of the field condensate for determining the amount of OET. Western objected to the assessment for field condensate, contending that field condensate was produced after the custody transfer meter and was therefore not recovered "on the lease" as required by the definition of "oil" in Section 57-51.1-01(3), N.D.C.C.

An administrative hearing officer determined that field condensate was "oil" under Section 57-51.1-01(3), N.D.C.C. The hearing officer construed "all liquid hydrocarbons that are recovered from gas on the lease" to mean liquid hydrocarbons recovered in Western's gathering system before the inlet receiver at the TR Plant. The hearing officer recommended that Western be assessed an OET of $129,483.71. The Commissioner substantially adopted the hearing officer's findings of fact, conclusions of law, and recommendation. However, under Section 57-51-10, N.D.C.C., the Commissioner found good cause for waiving one hundred percent of the penalty and twenty percent of the interest on the OET. The Commissioner thus ordered Western to pay an OET of $129,483.71 plus eighty percent of the interest.[1] The district court affirmed the Commissioner's decision, and Western appealed.

Section 28-32-19, N.D.C.C., governs our review of decisions by an administrative agency. We affirm an agency decision unless its findings of fact are not supported by a preponderance of

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[1] According to the Commissioner's Assessment, the tax and interest due through May 1991 is $238,377.70.

evidence, its conclusions of law are not supported by its findings of fact, its decision is not supported by its conclusions of law, or its decision is not in accordance with the law. Section 28-32-19, N.D.C.C.; *Schiff v. North Dakota Workers Compensation Bureau*, 480 N.W.2d 732 (N.D. 1992).

Western argues that field condensate is not "oil" as defined by Section 57-51.1-01(3), N.D.C.C., because it is not recovered "on the lease." Western asserts that "on the lease" means facilities ending with the custody transfer meter. Western contends that its processing plant begins at the custody transfer meter and therefore field condensate is produced at its processing plant and not "on the lease." The Commissioner responds that "on the lease" means facilities ending with the inlet receiver at the TR Plant. The Commissioner thus argues field condensate is a liquid hydrocarbon that is recovered from gas "on the lease" because it is recovered before the inlet receiver at the TR Plant.

The interpretation of a statute is a question of law and is fully reviewable by this court. *Rocky Mountain Oil & Gas Ass'n v. Conrad*, 405 N.W.2d 279 (N.D. 1987). In construing statutes, our primary objective is to ascertain the intent of the Legislature. *Id.* The Legislature's intent must be sought initially from the language of the statute. *Peterson v. Heitkamp*, 442 N.W.2d 219 (N.D. 1989). If the language of a statute is clear and unambiguous, we cannot ignore that language under the pretext of pursuing its spirit because the legislative intent is presumed clear from the face of the statute. *County of Stutsman v. State Historical Society*, 371 N.W.2d 321 (N.D. 1985); Section 1-02-05, N.D.C.C. However, if the language of a statute is ambiguous, the court may resort to extrinsic aids to interpret the statute. *County of Stutsman, supra*. A statute is ambiguous if it is susceptible to differing but rational meanings. *Rott v. Connecticut General Life Ins. Co.*, 478 N.W.2d 570 (N.D. 1991).

In this case, the definition of oil, particularly the extent and meaning of the "on the lease" modifier, is susceptible to different meanings. Both parties have presented rational interpretations of that language. We therefore conclude that the definition of "oil" in Section 57-51.1-01(3), N.D.C.C., is ambiguous.

Section 1-02-39, N.D.C.C., describes extrinsic aids which may be used to ascertain legislative intent when a statute is ambiguous. These include:

"1. The object sought to be attained.

"2. The circumstances under which the statute was enacted.

"3. The legislative history.

"4. The common law or former statutory provisions, including laws upon the same or similar subjects.

"5. The consequences of a particular construction.

"6. The administrative construction of the statute.

"7. The preamble."

The Commissioner construed "on the lease" to include all facilities prior to the inlet receiver to the TR Plant. The Commissioner thus concluded that field condensate was oil under the OET. The administrative construction of a statute by the agency administering the law is entitled to deference if that interpretation does not contradict clear and unambiguous statutory language. *Rocky Mountain Oil & Gas Ass'n, supra*; *Stutsman County, supra*; *see* Section 1-02-39(6), N.D.C.C. Administrative deference is an important consideration when an agency interprets and implements a law that is complex and technical. *True v. Heitkamp*, 470 N.W.2d 582 (N.D. 1991). Here, the Commissioner's interpretation is especially persuasive and entitled to deference because of the complex and technical nature of the OET and because that interpretation comports with the language of the statute and the legislative history. *See* Section 1-02-39(3), N.D.C.C.

The OET was originally approved by the voters as an initiated measure on November 4, 1980. 1981 N.D.Sess. Laws ch. 649. As originally approved, the OET defined "oil" as "petroleum, crude oil, mineral oil, casinghead gasoline, and all liquid hydrocarbons that are recovered from gas by means of a separator, or by other nonmechanical methods, incidental to the production of the gas." *Id.* at § 4. The 1981 Legislature changed "by means of a separator, or by other nonmechanical methods" to "on the lease." 1981 N.D.Sess. Laws ch. 612, § 2.

The legislative history for that change indicates that representatives from the oil and gas industry initially requested the same definition of oil for both the OET and the Gross Production Tax [GPT], Ch. 57-51, N.D.C.C.[2] March 9, 1981 Minutes of Senate Finance and Taxation Committee regarding HB 1651. However, representatives from the Tax Department requested a broader definition of oil under the OET to ensure that liquid hydrocarbons like light crude were taxable. *Id.*; March 11, 1981 Minutes of Senate Finance and Taxation Committee regarding HB 1651; *see also* March 20, 1981 Conference Committee regarding HB 1651. In explaining why members of the oil and gas industry wanted the same definition of oil for both the OET and the GPT, counsel for the Tax Department said that members of the industry were concerned that the term "nonmechanical methods" might allow the Commissioner to impose an OET on liquid hydrocarbons processed at a gas plant. March 11, 1981 Minutes of Senate Finance and Taxation Committee regarding HB 1651. However, counsel explained that the Commissioner did not intend to impose the OET on liquid hydrocarbons processed at a gas plant. *Id.* Representatives from the oil and gas industry then requested clarification of "nonmechanical methods" and it was agreed to substitute "on the lease" for "nonmechanical methods." *Id.*

Although Western asserts that a contrary legislative intent is shown by one legislator's statement that oil meant "liquid

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[2] Section 57-51-01(5), N.D.C.C., defines "oil" under the gross production tax as "petroleum, crude oil, mineral oil, and cashinghead gasoline."

hydrocarbons that are recovered from gas and this is on the site," the legislative history, as a whole, indicates a legislative intent to tax liquid hydrocarbons recovered before processing at a gas plant, but not liquid hydrocarbons processed at a gas plant. The technical meaning of processing[3] indicates that processing does not include normal field processes like compression, natural pressure reduction, and heating. H. Williams & C. Meyers, Manual of Oil and Gas Terms, 954 (8th ed. 1991). That technical definition supports the Commissioner's interpretation of "on the lease" in this complex and technical area.

Although we generally attempt to resolve questions of doubtful legislative intent in favor of the taxpayer [*Great Northern Railway Co. v. Flaten,* 225 N.W.2d 75 (N.D. 1974)], the legislative history, as a whole, establishes a clear legislative intent that "all liquid hydrocarbons that are recovered from gas on the lease" means liquid hydrocarbons that are recovered before processing at a gas plant. The Commissioner's interpretation of "on the lease" comports with that legislative intent and is in accordance with the law.

Western contends that the Commissioner's interpretation violates due process and is arbitrary, capricious, and unreasonable because it does not adequately warn taxpayers. We disagree.

A statute is not unconstitutionally vague if its language, "when measured by common understanding and practice, gives adequate warning of the conduct proscribed and marks boundaries sufficiently distinct for judges and juries to fairly administer the law." *Stoner v. Nash Finch, Inc.,* 446 N.W.2d 747, 755 (N.D. 1989); *see County of Stutsman, supra.* A statute is not unconstitutionally vague merely because it is necessary to resort to extrinsic

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[3] "Processing" means "any process designed to remove elements or compounds (hydrocarbon and nonhydrocarbon) from gas, including absorption, adsorption, or refrigeration. Field processes which normally take place on or near the lease, such as natural pressure reduction, mechanical separation, heating, cooling, dehydration, and compression are not considered processing." H. Williams & C. Meyers, Manual of Oil and Gas Terms, 954 (8th ed. 1991).

aids to construe the statute. *State v. Schwalk,* 430 N.W.2d 317 (N.D. 1988); *see County of Stutsman, supra.*

Section 57-51.1-01(3), N.D.C.C., when considered in light of the clear legislative intent to tax hydrocarbons recovered before processing at a gas plant, provides adequate notice of the meaning of "on the lease."

With that interpretation in mind, we review the Commissioner's determination that field condensate is "oil" under Section 57-51.1-01(3), N.D.C.C. In reviewing an agency's findings of fact we do not make independent findings of fact or substitute our judgment for that of the agency. *Stepanek v. North Dakota Workers Compensation Bureau,* 476 N.W.2d 1 (N.D. 1991). Rather, our review is based upon whether a reasoning mind could have reasonably determined that the agency's findings were proved by the weight of the evidence from the entire record. *Power Fuels, Inc. v. Elkin,* 283 N.W.2d 214 (N.D. 1979).[4]

The Commissioner made elaborate findings about the procedures employed by Western, relying in part upon a videotape depicting the procedures employed in Western's gathering system and its processing facility. The Commissioner found that Western's gas plant did not include the gathering system and, instead, consisted of the processing facility located after the inlet receiver at the TR Plant. Although Western presented contrary evidence, the Commissioner's expert, Dr. E. Hunter Herron, testified that a gas plant generally begins at the plant gate and that the TR Plant begins at the inlet scrubber or receiver. The Commissioner also found that field condensate was a liquid hydrocarbon, recovered before the inlet scrubber at the gas plant.

After reviewing the record, including the videotape, we agree that a reasoning mind could reasonably conclude that Western's plant began at the inlet receiver of the TR Plant and

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[4] This somewhat awkwardly phrased test is taken from *State Insurance Commissioner v. National Bureau of Casualty Underwriters*, 248 Md. 282, 236 A.2d 282 (1967).

that field condensate was recovered outside the gas plant. The Commissioner's findings of fact are supported by a preponderance of the evidence. Those findings of fact support the Commissioner's conclusion of law and determination that field condensate is a liquid hydrocarbon that is recovered from gas on the lease and is therefore "oil" under Section 57-51.1-01(3), N.D.C.C.[5]

Western also asserts that the Commissioner's determination that good cause existed under Section 57-51-10, N.D.C.C.,[6] for abating only twenty percent of the interest in this case is not supported by the findings of fact. Western asserts that one hundred percent of the interest should have been abated.

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[5] Because of our resolution of this issue, we need not determine if the Commissioner's findings that field condensate is petroleum, crude oil, mineral oil, and casinghead gasoline under Section 57-51.1-01(3), N.D.C.C. are also supported by a preponderance of evidence. Our resolution of this issue makes it unnecessary to consider if "on the lease" also modifies "pertroleum, crude oil, mineral oil [and] casinghead gasoline" under Section 57-51.1-01(3), N.D.C.C.

[6] For purposes of administration of the OET, Section 57-51.1-05, N.D.C.C., incorporates the provisions of Chapter 57-51, N.D.C.C., for administration of the GPT, including payment of interest and penalties.

Section 57-51-10, N.D.C.C., provides:

> "*Proceedings and penalty on delinquency.* Where the tax provided for in this chapter shall become delinquent, there is hereby imposed a penalty of five dollars, or a sum equal to five percent of the tax due, whichever is greater, together with interest at the rate of one percent per month on the tax due, for each calendar month or fraction thereof during which such delinquency continues, excepting the month within which such tax became due, which shall be collected in the manner hereinafter provided. If any person shall fail to make any report herein required, within the time prescribed by law for such report, it shall be the duty of the commissioner to examine the books, records, and files of such person to ascertain the amount and value of such production to compute the tax thereon as provided herein, and he shall add thereto the amount of any penalties accrued thereon. The Commissioner, in his discretion for good cause shown, may waive the penalty or the interest provided by this section."

Section 57-51-10, N.D.C.C., provides that the Commissioner "in his discretion for good cause shown, may waive the penalty or the interest" for delinquent taxes. In addition to the explicit language according discretion to the Commissioner, the use of the word "may" also ordinarily implies discretionary action. *Murie v. Cavalier County,* 68 N.D. 242, 278 N.W. 243 (1938). In this case the Commissioner informed Western in 1984 that field condensate was subject to the OET. No taxes were paid and the State has not had use of that tax money in the interim. Under these circumstances, we cannot say that the Commissioner abused her discretion in abating only twenty percent of the interest.

Western also requests attorney's fees under Section 28-32-21.1, N.D.C.C. Western is not a prevailing party under that statute and therefore is not entitled to attorney's fees.

We affirm the district court judgment.

Part B

IN THE SUPREME COURT
STATE OF NORTH DAKOTA

Western Gas Resources, Inc.,
successor in interest to
Western Gas Processors, Ltd.,
Plaintiff-Appellant,

vs.

M. K. Heidi Heitkamp,
Tax Commissioner of the
State of North Dakota,
Defendant-Appellee.

JUDGMENT
File No. 920024

Appeal from the District Court for Burleigh County.

This appeal having been heard by the Court at the May, 1992, term before:

The Honorable Ralph J. Erickstad, Chief Justice; the Honorable Gerald W. VandeWalle, the Honorable Herbert L. Meschke, the Honorable Beryl J. Levine, the Honorable J. Philip Johnson, Justices;

and the Court having considered the appeal, it is ORDERED AND ADJUDGED that the judgment of the court below be and the same is hereby AFFIRMED.

It is further ordered and adjudged that Appellee have and recover from Appellant costs and disbursements on this appeal, to be taxed and allowed in the court below.

Dated: August 19, 1992.

By the Court:

_____

Chief Justice
North Dakota Supreme Court

Attest: _____
Clerk of the Supreme Court

[Seal]

Part C

STATE OF NORTH DAKOTA
COUNTY OF BURLEIGH

IN THE DISTRICT COURT
SOUTH CENTRAL JUDICIAL DISTRICT

Western Gas Resources, Inc., successor in interest to Western Gas Processors, Ltd., *Plaintiff-Appellant,* vs. M. K. Heidi Heitkamp, Tax Commissioner of the State of North Dakota, *Defendant-Appellee.*	MEMORANDUM DECISION Civil No. 91-C-1538

Appellant buys gas from oil producers. At the well site, the gas passes through a custody transfer meter. The gas then enters appellant's gathering system on its way to appellant's processing facility or plant. After the gas passes through the custody meter but before it enters the plant inlet field condensate may be produced. This is field condensate as contrasted to plant condensate. The appellee seeks to tax this field condensate pursuant to Chapter 57-51.1 under the definition of oil in 57-51.1-01(3). The two parties have a differing construction of this definition and present rational arguments on both sides of the issue thereby supporting the conclusion that the statutory definition is ambiguous.

Appellant claims that its plant begins at the custody meter rendering the condensate a processed product not within the definition of oil since it is not produced on the lease. Appellee contends the condensate falls within the definition and is taxable. To the extent that it simplifies matters, both parties agree that the condensate is a liquid hydrocarbon. However, this does not cure the ambiguity and may perhaps deepen it.

The appellee's construction of the definition is a sound one based on the legal precedent cited on page 19 of the brief and on the legislative history furnished. Thus petroleum crude oil and casinghead gasoline need not be recovered on the lease to be taxable. Appellant's contrary interpretation leads to an absurdity because that construction would only tax the various products listed in the definition if recovered from gas on the lease incidental to the production of gas. This is clearly not the statutory intent.

The hearings officers finding No. 25 that this field condensate is petroleum, crude oil and casinghead gasoline is supported by the evidence. The conclusion of taxability is supported by the finding.

On page 2 of its brief, appellant lists the finding which are claimed not to be supported by the evidence. However, the evidence record contains a preponderance of evidence supporting the findings. Appellant seeks to have this court substitute its judgment but this is beyond the appellate function. The findings in turn support the conclusions.

Based on the admitted ambiguity in the statute, appellant contends the statute is unconstitutionally vague. The standard for ambiguity is simply based on making two rational arguments for contrary positions. After applying the rules of construction the ambiguity is easily removed. I cannot agree that every ambiguous statute is unconstitutionally vague. *Stoner vs. Nash-Finch, Inc.*, 446 N.W.2d 747, 755, sets out the appropriate vagueness standard. After the application of rudimentary rules of construction, the meaning of the statute is fairly ascertainable from the viewpoint of a reasonable person subject to its terms. Legal arguments may cloud the issue, but the rules of construction have dissipated those clouds, and any due process violation. Nor is the statute of such doubtful meaning so as to give appellant the benefit of a construction in its favor.

Decision affirmed.

I ask that appellee's attorney immediately submit an appropriate order for my signature.

Dated this 14th day of November, 1991, at Mandan, North Dakota.

BY THE COURT:

_____

WILLIAM F. HODNY
DISTRICT JUDGE

Part D

STATE OF NORTH DAKOTA
COUNTY OF BURLEIGH

IN THE DISTRICT COURT
SOUTH CENTRAL JUDICIAL DISTRICT

Western Gas Resources, Inc., successor in interest to Western Gas Processors, Ltd., *Plaintiff-Appellant,* vs. M. K. Heidi Heitkamp, Tax Commissioner of the State of North Dakota, *Defendant-Appellee.*	JUDGMENT Civil No. 91-C-1538

Based upon the record before the Court, the Court's November 14, 1991 Memorandum Decision, the Court's November 18, 1991 letter, and the Court's Order for Judgment, it is ADJUDGED AND DECREED that the Tax Commissioner's decision in this case is affirmed.

WITNESS: The Honorable William F. Hodny.

Dated this 25th day of November, 1991.

Clerk of District Court
By Sharalynn Mills, Deputy

STATE OF NORTH DAKOTA
COUNTY OF BURLEIGH

IN THE DISTRICT COURT
SOUTH CENTRAL JUDICIAL DISTRICT

Western Gas Resources, Inc., successor in interest to Western Gas Processors, Ltd., *Plaintiff-Appellant,* vs. M. K. Heidi Heitkamp, Tax Commissioner of the State of North Dakota, *Defendant-Appellee.*	NOTICE OF ENTRY OF JUDGMENT Civil No. 91-C-1538

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YOU ARE HEREBY NOTIFIED that Judgment was entered in the above entitled case on November 25, 1991. A copy of the Judgment is annexed hereto and is hereby served upon you.

Patrick K. Stevens
Assistant Attorney General
Office of State Tax Commissioner
State Capitol-Eighth Floor
600 East Boulevard Avenue
Bismarck, North Dakota
58505-0599

Part E

ADMINISTRATIVE HEARING BEFORE THE NORTH DAKOTA STATE TAX COMMISSIONER STATE CAPITOL BISMARCK, NORTH DAKOTA 58505

IN THE MATTER OF: The Notice of Determination dated October 18, 1985, Against Ecological Engineering Systems, Inc., General Partner, Western Gas Processors, Ltd.	FINDINGS OF FACT AND CONCLUSIONS OF LAW

On October 18, 1985, North Dakota State Tax Commissioner (hereinafter "Tax Commissioner") issued a Notice of Determination — North Dakota Gross Production and Oil Extraction Tax — to Ecological Engineering Systems, Inc., General Partner, Western Gas Processors, Ltd. (hereinafter "Western Gas"). (Gross Production Tax and Oil Extraction Tax will hereinafter also be referred to as "GPT" and "OET.") The total assessment for both gross production tax and oil extraction tax for the period November 1979 through December 1983, including penalty and interest, was $967,351.96. The assessment was for the Teddy Roosevelt Gas Plant in Billings County, North Dakota (hereinafter "TR Plant"), based on an audit of that facility. On December 9, 1985, Western Gas filed its Administrative Complaint, Objections, and Request for Formal Hearing on the assessment. On March 6, 1986, the Tax Commissioner filed its Answer to Western Gas's Complaint. On March 5, 1986, the Tax Commissioner also served a Notice of Hearing on Western Gas. On March 26, 1986, the Tax Commissioner served upon Western Gas a Specification of Issues indicating the issue to be determined was "[w]hether Western Gas Processors, Ltd., correctly reported the gross value of condensate pursuant to N.D.C.C. Chapters 57-51 and 57-51.1 for the period November 1979 through December 1983."

On May 15, 1986, the Tax Commissioner issued a Notice of Determination — North Dakota Gross Production Tax — to Western Gas assessing Western Gas GPT for the period January through December, 1980, including penalty and interest, in the amount of $535,652.54, for the TR Plant. On May 15, 1987, the Tax Commissioner issued a Notice of Determination — North Dakota Gross Production Tax — to Western Gas assessing it GPT for the period January, 1981, through December, 1984, including penalty and interest, in the amount of $909,466.14 for the TR Plant.

After objection by Western Gas, the May 15, 1986 Notice of Determination and May 15, 1987 Notice of Determination were reconsidered by the Tax Commissioner and a Notice of Reconsideration and Assessment — North Dakota Gross Production Tax — was sent by the Tax Commissioner to Western Gas on November 30, 1987, assessing a total of $2,540,123.87 for the period from January 1981 through December 1984 for the TR Plant. On March 15, 1990, the Tax Commissioner issued an Order Dismissing Assessment and Complaint abating the Notice of Reconsideration and Assessment dated November 30, 1987, and dismissing Western Gas's Administrative Complaint dated December 30, 1987, with prejudice.

On March 15, 1990, the Tax Commissioner requested the designation of a hearings officer from the Administrative Hearings Officer Division of the Attorney General's Office to be appointed as hearing officer in this matter. On March 20, 1990, Allen C. Hoberg, Assistant Attorney General, was designated as hearing officer.

In a January 10, 1991 letter, the Tax Commissioner reduced the remaining assessment against Western Gas (1985 Assessment) to $277,203.48, including penalty and interest, stating that "the Tax Commissioner is abating that portion of the assessment that relates to what has been termed 'plant condensate'." The letter also noted that "the Tax Commissioner has decided not to dispute the valuation of the field condensate for the period a

issue based upon the contracts Western has had with the producers."

At the hearing, the Tax Commissioner and Western Gas stipulated that the assessed amount in controversy of the tax only, exclusive of penalty and interest, is $129,483.71 (reduction by $5,000 to be applied pro rata over the assessment period because of an exempt royalty).

On October 24, 1990, Western Gas filed a Motion to Amend Complaint, Objections and Request for Formal Hearing, and an Amended Administrative Complaint, Objections and Request for Formal Hearing. On November 1, 1990, the hearing officer granted the motion. On November 14, 1990, the Tax Commissioner filed an Answer to Amended Administrative Complaint, Objections and Request for Formal Hearing.

On May 8, 1990, a Notice of Prehearing Conference was issued, and a prehearing conference was subsequently held on May 30, 1990. A Prehearing Conference Order was issued on June 4, 1990. Thereafter, considerable discovery was undertaken and completed by the Tax Commissioner and Western Gas. On September 24, 1990, the hearing officer issued a Notice of Hearing setting the hearing on this matter for December 4-6, 1990, with the final prehearing conference to be held on November 26, 1990. On November 13, 1990, the hearing officer received the Tax Commissioner's Motion for Extension of Time. By Prehearing Order dated November 19, 1990, the hearing officer granted the motion and rescheduled the hearing for January 29-31, 1991. On January 9, 1991 the hearing officer issued a Notice of Final Prehearing Conference setting it for January 16, 1991 (a telephone conference was held). The Tax Commissioner and Western Gas both filed prehearing briefs with the hearing officer on January 15, 1991.

The hearing on this matter was finally held on January 29-30, 1991, in the Office of the State Tax Commissioner, State Capitol, Bismarck, North Dakota, with Gary C. Davenport,

Denver, Colorado (presenting the matter), John C. Walter, Denver, Colorado, and Ernest R. Fleck, Bismarck, representing Western Gas, and Patrick K. Stevens, Assistant Attorney General, representing the Tax Commissioner.

The only issue remaining in this matter is whether the field condensate recovered, gathered, or collected by Western Gas for the period from January 1, 1981 through December 31, 1983, is within the definition of oil for the purposes of the OET and therefore taxable under N.D.C.C. ch. 57-51.1. (The OET law became effective January 1, 1981. *See* 1981 N.D. Sess. Laws, ch. 649.) Restated, the issue is whether Western Gas is liable for the assessment of OET by the Tax Commissioner in the amount of $129,483.71, plus penalty and interest on that amount, which amount is six and one-half percent of sixty percent of the value of the field condensate recovered, gathered, or collected by Western Gas from a gas stream flowing to the TR Plant and purchased from producers by Western Gas during the period in question.

Before and at the hearing it became clear that there would not be much dispute about the facts in this matter, but considerable dispute about the facts as applied to the law and interpretation of the law.

Based on the prehearing briefs, the evidence presented at the hearing, and the post hearing briefs, the hearing officer makes the following recommended findings of fact and conclusions of law:

FINDINGS OF FACT

1. Western Gas is a gas processing company which is the owner and operator of a natural gas gathering system and a processing facility known as the Teddy Roosevelt Gas Plant (TR Plant) in Billing County, North Dakota.

2. For its TR Plant, Western Gas purchases a gas stream (vapor stream or wet gas stream) from various oil and gas producers. This is a typically rich gas stream — a casinghead gas — which will consist of methane, ethane, propane, butane, and natural gasoline (pentane, hexane, and heptane). It may also have some hydrogen sulfide and carbon dioxide in it. Based on an agreement, the oil and gas producers get paid by Western sixty percent of the value of the liquids resulting from this gas stream.

3. Western Gas is not a producer of gas or oil in this state, nor does Western Gas have any ownership interests in oil or gas wells in North Dakota. Western Gas purchases the gas stream from various oil and gas producers in this state and then moves that gas stream through its gathering system and processes that gas stream at its facility (the TR Plant).

4. The field condensate that is the subject matter of the 1985 assessment by the Tax Department passes through an orifice meter, which is the custody transfer point, still in a vapor form. This field condensate is a component of the gas stream for which Western Gas pays the producer (sixty percent of the liquids collected).

5. Western Gas takes custody and ownership of the gas stream at the orifice meter, near the well cite. This meter is commonly referred to as the "custody transfer meter."

6. Western Gas purchases the gas stream from oil and gas producers for, among other things, processing it at the TR Plant. The gas stream is moved to the TR Plant through a gathering system. Both the gathering system and the TR Plant are owned and operated by Western Gas.

7. At the well cite, there is a pumping unit that draws gas, oil, and water from the earth, which is then passed through a separator (lease separator or three phase separator). The separator separates the oil, gas, and water phases. The producer retains all of the oil, the water is disposed of, and the gas stream flows through the custody transfer meter. The custody transfer

meter is also an accounting meter between Western Gas and the producers.

8. As the gas stream moves through the gathering system from the custody transfer meter, changes in pressure and temperature result in the gathering system, and liquids condense in the pipeline. These liquids are referred to as "drips" or "field condensate." They are recovered and stored in a drip storage tank. In addition to the drips, field condensate is also recovered at field compressor stations along the pipeline prior to the inlet of the TR Plant. The compressor stations are necessary to help move the gas stream to the TR Plant. Field condensate recovered at the compressor stations is obtained by formations in the same manner as drips, and as a result of compression in three stages. These (liquid) drips are also field condensate.

9. There are also liquids recovered at the TR Plant, a result of processing at the plant, that are referred to as "plant condensate."

10. All of the field condensate is recovered as a result of Western Gas's activities in the gathering system.

11. If Western Gas or another purchaser did not purchase the gas from the producers and provide for the gathering system and the TR Plant, there would be no condensate (field or plant condensate) produced. The recovery of condensate is a result of the activities by Western Gas in constructing and operating its gathering system and processing facility.

12. The October 18, 1985 assessment of Western Gas for gross production tax and oil extraction tax due on plant and field condensate for the period from November 1979 through December 1983 values the condensate for tax purposes at one hundred percent of the revenues Western Gas received for the sale of the condensate. Pursuant to contract between Western Gas and producers, however, Western Gas pays the producer sixty percent of the revenues it receives for the sale of condensate. The Tax Commissioner is no longer challenging the taxable value of the

field condensate. If tax is due on field condensate, the Tax Commissioner maintains that tax will be paid on sixty percent of the revenues Western received from the sale of the field condensate. *See* Tax Commissioner's January 10, 1991 letter (Exh. 20). Additionally, Western Gas and the Tax Commissioner stipulated at the hearing to a new amount to be assessed ($129,483.71) (the amount of tax now in issue), which amount represents six and one-half percent (the tax rate) of sixty percent of the value of the field condensate purchased by Western Gas for the TR Plant from January 1981 through December 1983.

13. The Tax Commissioner has conceded that Western Gas is not liable for plant condensate which it concedes is not subject to oil extraction tax. Although Western Gas's contracts with producers generally define "gas plant" or "plant" as including the whole gathering system and processing facility from the custody transfer meter on, and the industry considers the gathering system and the processing facility to be an integrated system, documents and testimony indicate a clear distinction between the gathering system (from the custody transfer meter) to the plant gate (TR Plant inlet scrubbers) and the processing facility. It is the processing facility which is usually referred to as the gas plant or the TR Plant.

14. Casinghead gas has been defined as "gas produced with oil in oil wells, the gas being taken from the well through the casinghead at the top of the well, as distinguished from gas being taken from a gas well." *Amerada Hess Corp. v. Conrad*, 410 N.W.2d 124, 131 N.9 (N.D. 1987); *see* H. Williams and C. Meyers, *Manual of Oil and Gas Terms* (7th Ed., 1987) 120. Thus, casinghead gas is gas that is taken from oil wells.

15. Casinghead gasoline is gasoline taken from casinghead gas or liquid hydrocarbons separated from casinghead gas by reduction of pressure at the well head or by a separator, absorption plant, or a manufacturing process, *see Manual of Oil and Gas Terms*, at 121. Casinghead gasoline is an archaic term, historically a product of gasoline plant processing, that can be applied to both field and plant condensate. It implies a light

liquid hydrocarbon. Casinghead gasoline cannot be recovered from the field separator in the normal operation of a field separator.

16. Condensate refers to field condensate, plant condensate, and retrograde condensate. Field condensate is liquid hydrocarbons recovered after the transfer meter point but before the inlet scrubbers of the gas plant. Plant condensate is liquid hydrocarbons recovered at the gas plant. Retrograde condensate is condensate at the well cite (it exists in the reservoir). But generally, condensate is recovered after the custody transfer point (meter). *See Manual of Oil and Gas Terms*, at 172, which says the term is defined in § 1.16 of the Model Form for an Oil and Gas Conservation Statute (1959), approved by the Legal Committee and the Interstate Oil Compact Commission as follows: "'Condensate' means liquid hydrocarbons that were originally in gaseous phase in the reservoir."

17. Field condensate is not a refined, processed product recovered at the gas plant. Plant condensate is a product recovered through processing at the gas plant (gas plant being described as the processing facility located after the plant inlet scrubber separator and not including the gathering system).

18. The gas stream (vapor or casinghead gas) passing through the orifice meter contains some components typically thought of as liquids and some components thought of as gases, but all components happen to be in a vapor state at the point they pass through the meter. Even some crude oil that is separated out at the lease (field) separator before the orifice meter has some gases in it. The tank storing the crude oil from the lease separator is known as the lease condensate storage tank or the crude oil tank.

19. Both field and plant condensate are also known as industrial gas liquids. They are liquifiable components of the gas stream. Pressure, temperature, flow configuration, and composition of the gas dictate where condensate is produced.

20. All liquid hydrocarbons can be classified based either on where they are recovered or by chemical composition. It is field practice to classify liquid hydrocarbons by where they are recovered. But it is industry practice to treat condensate distinctly as both plant condensate and field condensate and to, eventually, treat condensate as crude oil, as a result of what happens to that condensate once it is recovered. (It is relevant how industry treats condensate once it is gathered or processed.)

21. Both the field condensate and the plant condensate recovered by Western Gas are sold at crude oil posted prices. In addition, other companies in the oil and gas industry pay crude oil prices for field and plant condensate. (Prices posted in crude oil price bulletins are for both crude oil and condensate.)

22. After Western Gas sells its field condensate, the field condensate is combined with crude oil in storage tanks and transported in crude oil pipelines.

23. The evidence indicates that the chemical composition of condensate is identical to casinghead gasoline and is virtually the same as a "light" crude oil.

24. Field condensate, plant condensate, petroleum, crude oil, and casinghead gasoline are all liquid hydrocarbons. Generally, the term petroleum equates with the term liquid hydrocarbon.

25. Field condensate is petroleum. It is also a crude oil, a casinghead gasoline, and a liquid hydrocarbon.

26. Crude oil is liquid petroleum as it comes out of the ground as distinguished from refined oils manufactured out of it. Crude oil is produced at the well by ordinary production methods. *See Manual of Oil and Gas Terms*, at 201.

27. Condensate is a part of the oil extracted from the earth, but is generally not recovered at the well cite or well head. All liquid hydrocarbons are originally extracted from the earth at the well cite, however.

28. Western Gas is not actually involved in extracting oil from the earth. Western Gas is not actually involved in extracting condensate from the earth. Rather, oil, including condensate, is extracted from the earth by the producers from whom Western Gas purchases condensate. For purposes of paying the oil extraction tax, it doesn't matter that Western Gas extracted no oil or condensate from the earth. The field condensate was extracted from the earth (an activity that is taxed by means of assessing gross value at the well of the oil extracted) by the producer. The field condensate is recovered by Western Gas, for which it pays the producer. Field condensate falls within the definition of oil under OET statutes, and, therefore, pursuant to the provisions of ch. 57-51.1, Western Gas must pay the tax, and is liable for the tax.

29. Although its position in regard to other assessments, or parts of assessments against Western Gas, have changed, the Tax Commissioner has always maintained that condensate is taxable under the oil extraction tax and gross production tax. The Tax Commissioner has never represented otherwise to Western Gas. In addition, the Tax Commissioner has never represented to Western Gas that it would not have to pay taxes on any of the hydrocarbons it purchases.

30. At the time the Notice of Determination was issued in October 1985, the producers from whom Western Gas purchased the gas stream during the audit period in question were still doing business with Western Gas. By November of 1990, however, many of those producers had changed.

31. The Tax Commissioner first informed Western Gas of the taxability of condensate in September of 1984. After the Tax Commissioner issued the assessment in 1985, Western Gas discussed the assessment with its producers. Western Gas chose not to take any action to ensure that it could recover any tax from the producers in the event Western Gas was held liable for the tax. Rather, Western Gas chose to contest the matter.

32. Western Gas has paid no tax as a result of the 1985 assessment (or any of the other assessments no longer in issue in this matter). As between the Tax Commissioner (the State of North Dakota) and the ultimate payers of the tax (the producers-owners of the oil — those extracting the oil from the earth), if the tax is owed, the state has not had use of the money it is owed, as it should have, for all the time since the assessment until now. Instead, the purchaser of the gas stream (in this case Western Gas) made payments to the producers without collecting the tax. In other words, the producers had the use of money that was owed to the State of North Dakota, which situation was brought about by Western not collecting and paying the tax.

33. The evidence does not show that the Tax Commissioner is estopped from collecting the tax, penalty, or interest in this case, nor does good cause exist for waiving penalty and interest.

COMMENTARY ON BURDEN OF PROOF

At the final prehearing conference, the hearing officer informed Western Gas that it would have the burden of proof in this matter. As it develops, the burden of proof in this matter involves both factual and mixed factual — legal questions (but, primarily, this matter turns on legal questions and interpretations, what the law means as applied in this matter). In any event, Western Gas has not met its factual burden of proof, establishing facts which will result in a different legal conclusion than the Tax Commissioner proposes.

Based on the foregoing findings of fact, the hearing officer makes the following recommended conclusions of law:

CONCLUSIONS OF LAW

1. The field condensate at issue in this matter is, by the greater weight of the evidence, casinghead gasoline, crude oil, or petroleum, as those terms are used in N.D.C.C. § 57-51.1-01(3).

2. The section 57-51.1-02 tax (OET) is an excise tax on "the activity in this state of extracting oil from the earth," and requires that "every owner, including any royalty owner, *of any part of the oil extracted*" is "deemed . . . to be engaged in the activity of extracting that oil." (Emphasis supplied.) Because field condensate is a part of the oil extracted, the field condensate is subject to the tax imposed by section 57-51.1-02. Although the tax is an excise tax imposed on an activity, the tax is paid based on an assessment of a six and one-half percent rate of tax on the gross value at the well of the oil extracted.

3. N.D.C.C. § 57-51.1-05 states that the provisions of chapter 57-51 pertaining to the administration of oil and gas production tax law, including payment of the tax and interest and penalty thereon, govern the administration of the OET. N.D.C.C. § 57-51-05 requires, pursuant to the section 57-51.1-05 reference, that OET be paid by the purchaser at the time of production and authorizes the purchaser to deduct the amount of tax paid in making settlement with the producer or royalty owner. The producer only pays the oil extraction tax for that oil "not sold at the time of production but . . . retained by the producer." Western Gas is, therefore, liable to pay the oil extraction tax owed by the producer (owner, including any royalty owner) of the oil, including field condensate it recovers, even though it is not actually involved in the extraction of the oil from the earth. *See also* N.D.C.C. §§ 57-51-09, 57-51-11.

4. The Tax Commissioner is not estopped from collecting taxes, penalties, and interest in this matter.

5. Good cause, within the meaning of N.D.C.C. § 57-51.1-10, does not exist for waiving penalty and interest in this case.

COMMENTARY

The oil extraction tax began as an initiated measure, approved November 4, 1980. Its provisions were effective beginning January 1, 1981. *See* 1981 N.D. Sess. Laws, Ch. 649. As

originally enacted, the tax was an "excise tax, to be known as the 'oil extraction tax', upon the activity in this state of extracting oil from the earth . . ." *Id.* Oil was defined as "petroleum, crude oil, mineral oil, casinghead gasoline, *and all liquid hydrocarbons that are recovered from gas by means of a separator, or by other nonmechanical means, incidental to the production of the gas." Id.*, § 4(1) (Emphasis supplied.)

Shortly after the success of the initiated measure, the oil extraction tax was amended. *See* 1981 N.D. Sess. Laws, Ch. 612. Included in the amendments was a change to the definition of oil. The 1981 Legislative Assembly inserted in lieu of the words "by means of a separator, or by other mechanical methods," the words "on the lease". The definition of oil in the OET remains the same today. *See* N.D.C.C. § 57-51.1-01(3) (1989 Supp.). It reads as follows:

> 3. "Oil" means petroleum, crude oil, mineral oil, casinghead gasoline, *and all liquid hydrocarbons that are recovered from gas on the lease incidental to the production of the gas.*

(Emphasis supplied.)

At the time the oil extraction tax became law, the GPT already existed. *See* N.D.C.C. ch. 57-51. The GPT was a tax on the gross value at the well levied upon all oil and gas produced within the state of North Dakota. *See* N.D.C.C. § 57-51-02. For that tax, oil is defined as "petroleum, crude oil, mineral oil, and casinghead gasoline." N.D.C.C. § 57-51-01(4).

The OET is, then, an additional tax, an excise tax, which was added as an additional tax on oil, additional to the tax already existing in the form of the GPT. Additionally, the provisions of the GPT were specifically related to the OET by N.D.C.C. § 57-51.1-05. It provides, in part, that "the provisions of chapter 57-51 pertaining to the administration of the oil and gas production tax law . . . shall govern the administration of the tax imposed by section 57-51.1-02," and this relationship is "for

the purposes of administering the tax . . . " Even though the tax is not the same, the provisions of the two chapters (57-51 and 57-52) are closely related. *See also* N.D.C.C. § 57-51-05.1, the statute in regard to reclaimed oil, passed in 1983, another indicator to be read in conjunction with the OET provisions; Respondents' Prehearing Brief, at 22-24.

Since the establishment of both the GPT and the OET, various rules have been adopted by the Tax Commissioner in regard to the payment of those taxes. In regard to property tax exemptions found in N.D.C.C. §§ 57-51-03 and 57-51-04, "production" is defined as "the act of bringing oil or gas to the surface and to the point of measurement as to quantity and testing as to quality." N.D. Admin. Code § 81-02.1-03-01 (effective January 1, 1989). In regard to the GPT, several terms are now defined. N.D. Admin. Code § 81-09-02-01 (effective July 1, 1982, amended effective August 1, 1986, July 1, 1989) states, in part, as follows:

> **81-09-02-01. Definitions.** As used in this chapter and for the administration of North Dakota Century Code chapter 57-51, unless the context otherwise requires:
>
> 1. "Casinghead gas" means gas as produced from a well classified as an oil well by the Industrial Commission.
>
> * * *
>
> 4. "Natural gas" means gas as produced from a well classified as a gas well by the Industrial Commission.
>
> 6. "Oil" means petroleum, crude oil (*including condensate*), mineral oil, and casinghead gasoline.
>
> 8. "Producer" means the owner of a working interest or a nonoperating interest, in a well capable of producing oil or gas, or both.

> 9. "Purchaser" means any buyer of oil or gas after it has been produced. Purchaser does not include one who acquires oil or gas in place in the earth through a lease, estate, or other interest. . . .

(Emphasis supplied.)

Additionally, N.D. Admin. Code § 81-09-02-10 (effective August 1, 1986) states as follows:

> **81-09-02-10. Condensate.** The gross value at the well includes the value of condensate from associated and nonassociated production. The value of condensate is included in the gross value regardless of the point at which it is recovered. This includes, but is not limited to, condensate recovered at the lease cite, compressor station, and processing plant.

N.D. Admin. Code § 81-09-03-01 applies all of the rules adopted in chapter 81-09-02 to the administration of the OET law (unless in conflict).

Implementating rules adopted after the effective date of a statute are not conclusive of the meaning of the statute prior to their adoption (these rules were all adopted after 1981 when the OET provisions became effective, and most were adopted after the time period of the assessment of the tax). But, they must be given some consideration as guides in determining the meaning of statutory provisions. *See* 1A Sutherland, *Stat. Const.* § 31.06 (4th Ed., 1984); *Cf. Smith v. N.D. Worker's Comp. Bureau*, 447 N.W.2d 250, 255 (N.D. 1989).

Nevertheless, it is known what statutes are controlling in this matter — N.D.C.C. § 57-51.1-02 imposes the tax, N.D.C.C. § 57-51.1-01(3) defines oil (that which is taxed), and N.D.C.C. § 57-51.1-05 applies the provisions of chapter 57-51 for purposes of administering the tax.

A statute is an instrument of government partaking of its practical purposes but also of its infirmities and limitations, of its

awkward and groping efforts. *See* 2A Sutherland § 45.01. But a statute is a medium of communication, which communication does not take place in a vacuum. The issue in matters such as this one, is almost always one which depends on the interpretation or construction of the language of the act. *Id.*

Ambiguity (in a statute) has been defined as whether a statute is capable of being construed in two different ways by reasonably well-informed people. *Id.*, at § 46.04. The definition of oil found in N.D.C.C. § 57-51.1-01(3) is ambiguous. It is therefore imperative for the decisionmaker in this matter to interpret the meaning of the words and construe the statute (apply the words to the facts). (Sometimes interpretation and construction are used interchangeably.)

It is well recognized in statutory interpretation or construction that "[i]n all cases the object is to see what is the intention expressed by the words used. But, from the imperfection of language, it is impossible to know what the intention is without inquiring further, and seeing what the circumstances were with reference to which the words were used, and what was the object, appearing from those circumstances, which the person using them had in view; for the meaning of the word varies according to the circumstances with respect to which they were used." *Id*, at § 45.05, *citing River Wear Com'rs. v. Adamson*, L.R. 2 AC 743 (1877).

In other words, the intent of the legislature governs decisions in regard to the construction of statutes. It is the intent of the legislature that is most often cited as a criteria for a decision concerning the applicability of a statute. Decisionmakers must carry out the will, real or attributed, of the legislature. *Id.*, at §§ 45.05, 45.08.

In this matter the decisionmaker ought to be concerned with what the legislature's intent is (what the legislature meant by the statute), more so than the meaning of the statute (what it means or has come to mean to the members of the public or to

the industry) since the passage of the legislation. This is especially so because, apparently, the term "on the lease" is not a term originally applied to situations such as Western Gas would (and others may) like to apply it in this matter, nor a term that is applied similarly elsewhere. "On the lease" is not even defined in the *Manual of Oil and Gas Terms* (*supra*). It also does not appear in *Words and Phrases*.

But, the meaning of the statute as far as its practical application cannot be ignored, either. *See* 2A Sutherland § 45.08.

The North Dakota Supreme Court has stated as follows:

> The interpretation of a statute is a question of law, fully reviewable by this court. . . . Our primary objective in the interpretation of a statute is to ascertain intent of the legislature. . . . We look first to the language of the statute. . . . If the language of a statute is clear and not ambiguous, the letter of the statute cannot be disregarded under the pretext of pursuing its spirit. . . . If a statute's language is ambiguous or of doubtful meaning, we may consider extrinsic aids, including legislative history, along with the language of the statute, to ascertain legislative intent. . . .

(Citations omitted.) *Smith v. N.D. Worker's Comp. Bureau*, 447 N.W.2d 250, 253 (N.D. 1989); *see also State v. Bower*, 442 N.W.2d 438 (N.D. 1989).

Additionally, statutes must be construed as a whole to assert and give effect to the legislative intent, and in determining legislative intent, the court may consider such matters as the object sought to be attained, the statute's connection to other related statutes, and the consequences of a particular construction. *State v. Moen*, 441 N.W.2d 643, 644 (N.D. 1989). *See* N.D.C.C. § 1-02-39.

In construing the statutory revisions, the Supreme Court considers the entire enactment of which it is a part, and, to the extent possible, interprets provisions consistent with the intent

and purpose of the entire act. *Production Credit Association of Minot, v. Lund*, 389 N.W.2d 585, 586-87 (N.D. 1986).

Additionally, in statutory interpretation, words must be given their plain, ordinary, and commonly understood meaning, and consideration should be given to the ordinary sense of the statutory words, the context in which they are used, and the purpose which prompted their enactment. *Peterson v. Heitkamp*, 442 N.W.2d 219, 221 (N.D. 1989); *see* N.D.C.C. § 1-02-02.

N.D.C.C. ch. 1-02 provides the primary basis for statutory rules of interpretation. In addition to those already referred to, the following are helpful in this matter:

> 1-02-03. **Language — How Construed.** Words and phrases must be construed according to the context and rules of grammar and the approved usage of the language. Technical words and phrases and such others as have acquired peculiar and appropriate meaning in law, or as are defined by statute, must be construed according to such peculiar and appropriate meaning or definition.
>
> 1-02-38. **Intentions in the enactment of statutes.** In enacting a statute, it is presumed that:
>
> 1. Compliance with the constitutions of the state of the United States is intended.
> 2. The entire statute is intended to be effective.
> 3. A just and reasonable result is intended.
> 4. A result feasible of execution is intended.
> 5. Public interest is favored over any private interest.
>
> 1-02-39. **Aids in construction of ambiguous statutes.** If a statute is ambiguous, the court, in determining the intention of the legislation, may consider among other matters:
>
> 1. The object sought to be attained.

2. The circumstances under which the statute was enacted.

3. The legislative history.

4. The common law or former statutory provisions including laws upon the same or similar subjects.

5. The consequences of a particular construction.

6. *The administrative construction of the statute.*

7. The preamble.

(Emphasis supplied.)

Using the rules of grammar, the first thing that needs to be resolved for interpreting the OET is the statutory definition of oil. One needs to determine the reference point of the statute, the meaning and use of several terms (petroleum, crude oil, mineral oil, and casinghead gasoline, all liquid hydrocarbons . . .), to see if the ambiguity concerning the different ways of interpreting the statute can be resolved. To do that one needs to determine what the words "that are recovered from gas on the lease incidental to the production of gas" modify.

The word "that" is a relative pronoun. Furthermore, it is a restrictive relative pronoun. Relative pronouns come, in most instances, immediately after their antecedent. The use of the relative pronoun "that" following the antecedent "hydrocarbons" means that the words in question modify only the words "liquid hydrocarbons" and not the words "petroleum, crude oil, mineral oil, casinghead gasoline." If a nonrestrictive relative pronoun had been used, such as "which," and/or a comma had appeared after the words "liquid hydrocarbons," the modifying words would have been used in a nonrestrictive sense and would have applied to all of the terms in a series, not just to liquid hydrocarbons. *See* W. Strunk and E.B. White, *The Elements of Style* (3rd Ed., 1979) 29, 59 (Strunk and White was referred to by Western Gas's expert as a basis for his conclusion that the modifiers in question modified all the terms in the series — his conclusion is rejected); *see also*, C. Hodges and M. Whitten, *Harbrace*

College Handbook (7th Ed., 1972) § 12d; A. Jordan, *The Writers Manual* (1966) § 11.5(F), 21.0(D); R. Morsberger, *Common Sense Grammar and Style*, (2d Ed., 1972) 240-241.

This interpretation of the relationship of words in the definition of oil is also in accordance with the rule of statutory construction known as the doctrine of the last antecedent. *See* 2A Sutherland, § 47.33. Where no contrary intention appears, referential qualifying words and phrases refer only to the last antecedent. Evidence that a qualifying phrase is supposed to apply to all antecedents instead of only to the immediately preceding one may be found in the fact that it is separated from the antecedents by a comma. *Id.; see Kaberna v. School Bd. of Lead — Deadwood*, 438 N.W.2d 542, 543 (S.D. 1989); *State Ex. Rel. DOT v. Gen. Elect. Cr. Corp.*, 448 N.W.2d 335, 345 (Iowa 1989); *State v. Kluesner*, 389 N.W.2d 370, 371-72 (Iowa 1986).

Unfortunately, even an interpretation of the definition so that all the terms but "all liquid hydrocarbons" stand on their own without modifiers does not necessarily resolve the ambiguity. Western Gas claims the doctrine of *ejusdem generis* applies. Application of this doctrine as indicated by Western Gas could result in a different interpretation of the statute than the Tax Commissioner's.

Western Gas's argument is basically that the last phrase, including modifiers ("all liquid hydrocarbons . . . gas"), is a general term that defines the class of specific terms, and condensate, then, can only be included as part of the definition of the general term (liquid hydrocarbons, etc.), as limited; otherwise the use of the general term words is superfluous and the definition redundant. Western Gas goes on to argue that because condensate does not fit within the other terms of the definition, the facts and legislative history as construed in regard to the last term mean that no condensate is recovered from gas on the lease incidental to the production of gas and therefore it cannot be taxed. In other words, Western Gas says condensate, considering the legislative history, does not fit the last term either.

But, the last term in the series ("all liquid hydrocarbons . . ."), as noted above, stands alone, and the doctrine of *ejusdem generis* does not clearly apply. One can argue that the term "petroleum" is either a general or specific term. "Crude oil" and "casinghead gasoline" are clearly specific terms. But, the last term ("all liquid hydrocarbons . . .") can be either general or specific. In fact, it seems to be more like a specific term. If so, it may even be narrowly construed to apply only to a small part of the class of all liquid hydrocarbons, depending on how one defines "on the lease," "incidental," and "production". Interpreted strictly, it may only be referring to a very specific liquid hydrocarbon, retrograde condensate, or condensate recovered from gas wells. But, just exactly what the last term means is ambiguous, without legislative history. If it is a specific term, it hardly defines the class or limits the inclusion of the term condensate within other specific terms. Then, condensate may be included within any of the specific terms, as long as it fits the definition.

Therefore, the doctrine of *ejusdem generis* is not clearly applicable. Moreover, this doctrine is a rule of construction used to carry out, not frustrate or defeat, legislative intent. The North Dakota Supreme Court has recently said that "the rule of *ejusdem generis* has been described as a manifestation of the bias towards strict construction of statutes in derogation of the common law (citations omitted). . . . This narrowing concept runs contrary to the rule of construction provided by our legislature that statutes are to be liberally construed to effectuate their objectives and promote justice. Section 1-02-01, N.D.C.C." *Aanenson v. Bastien*, 438 N.W.2d 151,156 (N.D. 1989).

The court then went on to say that the rule must not be used to subvert or defeat the legislative intent, should not be followed to arrive at a different intent from that of the legislature, and must not be used to lead to an absurd result. *See Id.*

First, Western Gas would have the statute read in a way (which, it maintains, is grammatically correct) that would be

absurd. Then it would have *ejusdem generis* applied to the definition of oil (apparently only if its grammatical reading is not accepted) that would frustrate the intent of the legislature. *Ejusdem generis* will not be applied as an aid to construction for the definition of oil in this matter.

Besides being grammatically correct and correct according to the rules of statutory construction, the construction proposed by the Tax Commissioner (that petroleum, crude oil, mineral oil, and all liquid hydrocarbons, etc., each stand alone as a part of the definition of oil) is supported by looking at the definition of oil in the GPT which existed prior to the initiated measure, by looking at the initiated measure, and by looking at what has happened to definitions since the OET was first established. The definition of oil existing before the OET is exactly the definition of the OET minus the last phrase ("all liquid hydrocarbons . . .") added by the OET. The initiated measure merely added a phrase indicating that all liquid hydrocarbons recovered from gas incidental to (meaning as a minor consequence of or occurring by chance in) the production of gas by means of a separator or by other nonmechanical means were also to be taxed as a part of the OET. This phrase could well refer to those liquid hydrocarbons recovered from gas, possibly just at gas wells (but probably also at oil wells), incidental to the production of gas (bringing the gas to the surface) prior to any mechanical means being used to recover the gas. In any event, these specific add-on words "by means of a separator, or by other nonmechanical means," were replaced with the words "on the lease" by 1981 Legislative Assembly.

After House Bill 1651 passed the House during the 1991 Legislative Assembly, the oil and gas industry requested that the definition of "oil" be changed. *Hearing on H. 1651 before the Sen. Comm. on Finance and Tax*, 47th Leg. (March 9, 1981) (Tape 31, side 2). At a hearing before the Senate Tax and Finance Committee, Cindy Coyle, a representative of Shell Oil Company, and Lowell Ridgeway, a representative from the North Dakota Petroleum Counsel, pointed out that the definition of "oil" for OET purposes was different from the definition of "oil" for GPT

purposes. *Id.* Ms. Coyle then proposed that the definition of "oil" for the OET be changed to mirror the definition of "oil" in the GPT. *Id.*

An attorney for the Tax Commissioner, Leo Wilking, responded to Ms. Coyle's comments. Mr. Wilking indicated that the language "all liquid hydrocarbons that are recovered from gas by means of a separator, or other nonmechanical methods, incidental to the production of gas" was added to ensure that even light crude oils were taxed. *Id.* (One has to wonder why it was necessary to add it, but this was an initiated measure.) Ms. Coyle then stated that it was not clear what constituted nonmechanical methods. *Id.* (Mr. Ridgeway also stated a concern over the meaning of "nonmechanical methods." *Id.* (March 11, 1981) (Tape 35).)

The discussion regarding the definition of "oil" continued on March 11, 1981. *See Hearing on H. 1651 Before Sen. Comm. Finance and Tax*, 47th Leg. (March 11, 1981), (Tapes 35 and 36). In explaining why the oil and gas industry wanted to cut the definition of "oil" for OET purposes to conform to the definition of "oil" for GPT purposes, Mr. Wilking stated:

> [A]pparently [the oil and gas industry's] worry was that we meant by including this in here that we were going to tax liquid hydrocarbons that were processed out at the plant. That is not our intention. . . .

Id. (Tape 35, side 1.) In response to a question, Mr. Wilking also stated that the Tax Commissioner did not intend to tax refined products. *Id.*

In addition, when later responding to a question regarding why the definition of "oil" was changed, Mr. Wilking stated:

> I think the industry's concern there was that we might be talking about gas that was at the point of being processed at the processing plant and we didn't have that intent in creating the definition of "oil".

Hearing on H. 1651 Before a Conference Committee, 47th Leg. (March 20, 1981) (Tape 47, side 2).

In addressing the Senate Committee, Mr. Wilking had indicated that he had discussed this matter with Ms. Coyle and that it was the oil and gas industry's concern that the Tax Commissioner was going to "tax liquid hydrocarbons that were processed out at the plant." *Hearing on H. 1651 before the Sen. Comm. on Finance and Tax*, 47th Leg. (March 4, 9, 1981) (Tape 31). Also, in response to a question from a legislator regarding the definition of oil, Mr. Wilking stated:

> As I understand it [the oil and gas industry's] problem, and correct me if I'm wrong, was with the idea of liquid hydrocarbons that are processed out at the processing plant being taxed at that stage.

Id.

Eventually the Tax Commissioner's Office and industry agreed to the definition of "oil" now contained in the OET. There were no discussions, however, specifically indicating what the new language was to include, but the Senate Finance and Tax Committee recommended a "due pass as amended" anyway, when H.B. 1651 went to a conference committee. There, Wilking again stated that the concern with the "nonmechanical methods" language was that the Tax Commissioner would be taxing "gas that was at the point of being processed at the processing plant. . . ." *Hearing on H. 1651 before a Conference Committee*, 47th Leg. (March 20, 1981) (Tape 47, side 2).

Additionally, Senator Moore in conference committee stated:

> The five percent and the six and one-half percent [tax] have different definitions of oil and oil under the five percent [CPT] means petroleum, crude oil, mineral, casinghead gasoline and stops there. Then there's additional language because under six and one-half percent [OET] they do not tax gas, they only do oil and

> it says, and if there is any liquid hydrocarbons that are recovered from gas and this is on site.

Id.

The legislative history of the OET indicates several points. First, the Tax Commissioner's Office did not intend to tax, "refined," or "plant" products. Second, that there was no discussion of the terms "petroleum, crude oil, mineral oil, and casinghead gasoline." Finally, the Tax Commissioner wanted to ensure that light crude oil was taxed.

The legislative history indicates that the language "and all liquid hydrocarbons that are recovered from gas on the lease incidental to the production of the gas" was included in the definition of oil to ensure that plant products, such as butane, propane, or natural gasoline, recovered or processed at the gas processing plant, would not be considered oil, and taxed as oil. Thus, anything prior to the inlet of the plant should be considered oil under section 57-51.1-01(3), and taxed as oil.

The Tax Commissioner in this matter is taxing a product, a liquid hydrocarbon, that is recovered by Western Gas before the inlet of the TR Plant, before processing. Even Western Gas admits that the clear meaning of the phrase "on the lease" in the OET definition of oil is to reinforce the understanding that the OET is a tax upon the activity of extracting oil from the earth and not upon the activity of "*processing*" natural gas once it is off the lease (emphasis supplied), *see* Post-Hearing Brief of Western Gas, at 18.

In addition, we know this liquid hydrocarbon — field condensate — is the equivalent of a light crude oil, is sold at crude oil prices, and is mingled with crude oil in a crude oil pipeline. In fact, it is, or can be, also considered to be petroleum, crude oil, or casinghead gasoline. Therefore, the legislative history supports a determination that the field condensate is meant to be taxed as oil within the meaning of ch. 57-51.1, specifically §§ 57-51.1-01(3) and 57-51.1-02.

It is apparent from the foregoing legislative history that representatives from the industry had expressed a concern to the Tax Commissioner at the time the definition of oil was amended in the oil extraction tax that the Tax Commissioner was going to tax liquid hydrocarbons that were processed at the plant. Without added language, plant condensate might possibly be taxed. The industry was concerned about that. (The original language does seem clearer than that substituted, however.) In response to industry's concern, the "on the lease" language was inserted in the new definition of oil. Analysis leads to the conclusion that the legislature's intent, in response to industry's concern, was that liquid hydrocarbons that were processed at the plant would not be subject to the oil extraction tax. Liquid hydrocarbons, such as field condensate, however, that are not processed at a plant would be subject to the OET.

In other words, the legislative history indicates that the language "and all liquid hydrocarbons that are recovered from gas on the lease incidental to the production of gas" is language added to the other terms in the series, but only added to exclude a specific subset of liquid hydrocarbons. Without this additional language all petroleum, crude oil, mineral oil, and casinghead gasoline would be taxed regardless of where recovered.

But, the add on language is not stated in terms of an exclusion. It is also not stated in terms of "all [other] liquid hydrocarbons . . ." Therefore, reading the last phrase, strictly interpreting just the words, makes the last phrase a very specific term within which not much falls, certainly not field condensate. (But field condensate and plant condensate can still be included within the meaning of the other specific terms.)

Construing the last phrase in terms of the legislative history, as an add on, an exclusion, means that field condensate is still included within one or more of the other specific terms, but plant condensate is not. Therefore, field condensate is taxed, but plant condensate is not. This is the legislative intent. This is the Tax Commissioner's interpretation or construction of the statute. It should be followed. *See Rocky Mountain Oil and Gas Ass'n v.*

Conrad, 405 N.W.2d 279, 283 (N.D. 1987); *see also Ladish Malting Co. v. Stutsman County, Etc.*, 351 N.W.2d 712, 720 (N.D. 1984).

Based on the foregoing findings of fact and conclusions of law, the hearing officer recommends that the 1985 assessment against Western Gas for the period from January 1981 through December 1983, imposing an OET liability of $129,483.71, exclusive of penalty and interest, is a legally correct assessment, and that Western Gas, a statutorily responsible party obligated to pay the tax as assessed, is liable to make payment of that amount plus applicable penalty and interest to the Tax Commissioner under terms as the Tax Commissioner may impose.

As a final comment, the hearing officer is obliged to note, even though the facts and law do not show an obligation on the Tax Commissioner to do so, that he believes consideration should be given to abating all or a portion of the penalty and interest (or at least the penalty) (whatever amount is finally due and owing) in this matter. This comment is based mostly on speculation, however, claims made by Western Gas, which seem to ring true. If Western Gas had been originally assessed what they are now finally assessed, they may have paid it without contest. If they had deducted the original tax claimed by the Tax Commissioner, they may have lost some clients, even if they would have held the money in escrow pending a final outcome. But, can it really be expected that they should have known to deduct and set aside exactly $129,483.71? Also, it is the producers who now have the money. They are the ones who really pay the tax — Western Gas is a vehicle. Does Western Gas really deserve a penalty? (Technically, yes.) Notwithstanding all this, which may be considered reasonable explanation of failure to pay, the fact that the language of the statute in question is ambiguous may be enough to provide the Tax Commissioner with the discretionary authority to abate the penalty, at least, if not the interest, under N.D.C.C. § 57-51-10.

Dated at Bismarck, North Dakota, this 8th day of May, 1991.

State of North Dakota
State Tax Commissioner

By: _____

Allen C. Hoberg
Assistant Attorney General
Office of Attorney General
Administrative Hearings
Officer Division
State Capitol
600 E. Boulevard Avenue
Bismarck, North Dakota
58505

Hearing Officer

Part F

STATE OF NORTH DAKOTA
OFFICE OF THE STATE TAX COMMISSIONER
STATE CAPITOL
600 E BOULEVARD AVENUE
BISMARCK, NORTH DAKOTA 58505-0599
701-224-2770

Heidi Heitkamp
COMMISSIONER

May 22, 1991

Mr. John Morrison
Fleck, Mather & Strutz
P.O. Box 2798
Bismarck ND 58502-2798

Mr. Gary Davenport
McGloin, Davenport, Severson & Snow
140 East 19th Avenue, Suite 400
Denver CO 80203

Mr. Pat Stevens
Assistant Attorney General
Office of State Tax Commissioner
State Capitol
600 East Boulevard Avenue
Bismarck ND 58505-0599

RE: In the Matter of Notice of Determination Dated October 18, 1985, Against Ecological Engineering Systems, Inc., General Partner, Western Gas Processors, Ltd.

Dear Gentlemen,

Enclosed please find a final order in the above referenced matter.

The hearings officer's Recommended Findings of Fact and Conclusions of Law are adopted with the following clarifications and exceptions:

1. Recommended Finding of Fact No. 14 is moved to page 14 and subsequently numbered as a Conclusion of Law.

2. Recommended finding of Fact No. 33 is modified by striking the phrase "nor does good cause exist for waiving penalty and interest."

3. Recommended Conclusion of Law No. 5 is stricken and replaced with the following:

> "Good cause, within the meaning of NDCC Section 57-51.1-10. exists for waiving 100% of the penalty and 20% of the interest on this case."

4. An additional Conclusion of Law is added which states as follows:

> "The 1981 Legislature intended the phrase, 'on the lease,' as contained in NDCC Section 57-51.1-01(3), to mean that refined products recovered at the gas plant are excluded from the oil extraction tax provided for in NDCC Chapter 57-51.1."

This Conclusion of Law is supported by the Recommended Commentary on pages 28 through 33 of the Hearing Officer's Recommendation.

I have also reviewed the Recommended Hearing Officer Commentary and offer the following additional comments:

1. In the first full paragraph on page 28 of the Commentary, the reference to the Legislative Assembly should be changed to refer to the 1981 Legislative Assembly and not the 1991 Legislative Assembly.

2. I do not believe the speculation contained in the first full paragraph of page 34 of the Commentary is justified by the record, and, accordingly, I do not incorporate that paragraph as part of my final decision. The total amount tax and

interest due in this matter, as calculated with interest through May of 1991, is $238,377.70.

Sincerely,

Heidi Heitkamp
TAX COMMISSIONER
STATE OF NORTH DAKOTA

HH: jv
Enclosure

c:\june\legal\western.2

Part G

ADMINISTRATIVE HEARING BEFORE THE NORTH DAKOTA STATE TAX COMMISSIONER STATE CAPITOL BISMARCK, NORTH DAKOTA 58505

IN THE MATTER OF: The Notice of Determination dated October 18, 1985, Against Ecological Engineering Systems, Inc., General Partner, Western Gas Processors, Ltd.	ORDER IMPOSING OIL EXTRACTION TAX

Pursuant to proceedings in this matter culminating in a hearing on January 29-30, 1991, the greater weight of the evidence presented at the hearing having shown, and the conclusions of law based on the evidence requiring:

That Western Gas is liable for oil extraction tax due on field condensate it recovered from a gas stream in route to its Teddy Roosevelt Gas Plant for the time period from January 1981, through December 1983.

IT IS HEREBY ORDERED that Western Gas pay the amount currently assessed for that time period ($129,483.71), plus eighty percent of the interest due pursuant to N.D.C.C. § 57-51.1-10.

Dated at Bismarck, North Dakota, this 22nd day of May, 1991.

State of North Dakota
State Tax Commissioner

Heidi Heitkamp

Part H

IN THE SUPREME COURT
STATE OF NORTH DAKOTA

Western Gas Resources, Inc.,
successor in interest to
Western Gas Processors, Ltd.
Plaintiff and Appellant

v.

M. K. Heidi Heitkamp,
Tax Commissioner of the
State of North Dakota,
Defendant and Appellee.

PETITION FOR
REHEARING
File No. 920024

Appeal from the District Court for Burleigh County.

This appeal having been heard by the Court at the May, 1992, term before:

The Honorable Ralph J. Erickstad, Chief Justice; the Honorable Gerald W. VandeWalle, the Honorable Herbert L. Meschke, the Honorable Beryl J. Levine, the Honorable J. Philip Johnson, Justices;

and a petition for rehearing upon the appeal herein having been filed by John W. Morrison and Gary C. Davenport for the appellant and the court having advised thereon, it is now here considered, ORDERED AND ADJUDGED, that the petition be and the same is hereby DENIED.

AND IT IS FURTHER ORDERED, that this cause be and it is hereby remanded to the District Court for further proceedings according to law, and the judgment of this court.

Dated: October 1, 1992

By the Court:

_____

Chief Justice
North Dakota Supreme Court

Attest: _____
Clerk of the Supreme Court

[Seal]

STATE OF NORTH DAKOTA,
IN THE SUPREME COURT, } ss.

The petition for a rehearing upon the appeal in the above entitled action is hereby Denied.

/s/ J. Philip Johnson

/s/ Gerald W. VandeWalle

/s/ Beryl J. Levine

/s/ Herbert L. Meschke

/s/ Ralph J. Erickstad

Judges Supreme Court,
State of North Dakota

STATE OF NORTH DAKOTA,
IN THE SUPREME COURT, } ss.

I, Penny Miller, Clerk of the Supreme Court within and for the State of North Dakota, do hereby certify that the above and foregoing is a full, true and correct copy of the original, as the same remains on file in my said office.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the Seal of said Court at Bismarck, this 23rd day of December 1992.

_____

Clerk, Supreme Court

Part I

IN THE SUPREME COURT
STATE OF NORTH DAKOTA

Western Gas Resources, Inc.,
successor in interest to
Western Gas Processors, Ltd.,
Plaintiff and Appellant.

v.

M. K. Heidi Heitkamp,
Tax Commissioner of the
State of North Dakota,
Defendant and Appellee.

JUDGMENT
File No. 920024

Appeal from the District Court for Burleigh County.

This appeal having been heard by the Court at the May, 1992, term before:

The Honorable Ralph J. Erickstad, Chief Justice; the Honorable Gerald W. VandeWalle, the Honorable Herbert L. Meschke, the Honorable Beryl J. Levine, the Honorable J. Philip Johnson, Justices;

and the Court having considered the appeal, it is ORDERED AND ADJUDGED that the judgment of the court below be and the same is hereby AFFIRMED.

It is further ordered and adjudged that Appellee have and recover from Appellant costs and disbursements on this appeal, to be taxed and allowed in the court below.

Dated: August 19, 1992.

By the Court:

_____

Chief Justice
North Dakota Supreme Court

Attest: _____
Clerk of the Supreme Court

Part J

IN THE SUPREME COURT
STATE OF NORTH DAKOTA } ss.

I, Penny Miller, Clerk of the North Dakota Supreme Court do hereby certify that the foregoing is a complete and agreed copy of the judgment of the Supreme Court, covered in the above entitled action. The same, together with the opinion of the Court, is hereby transmitted to the Court below as the mandate of the Supreme Court.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the Seal of said Court this 12th day of October 1992.

_____

Clerk of the Supreme Court

Part K

K-1

STATE OF NORTH DAKOTA
OFFICE OF THE STATE TAX COMMISSIONER
STATE CAPITOL
600 E BOULEVARD AVENUE
BISMARCK, NORTH DAKOTA 58505-0599
701-224-2770

Kent Conrad
COMMISSIONER

October 18, 1985

Mr. John M. Fox
Executive Vice President
Ecological Engineering Systems, Inc.
General Partner
Western Gas Processors, Ltd.
10701 Melody Drive
Northglenn, CO 80234

Federal I.D. Number 84-0738383

NOTICE OF DETERMINATION
North Dakota Gross Production and Oil Extraction Tax

You are hereby notified that the Tax Commissioner, in accordance with Sections 57-51-05, 57-51-06, 57-51-09 and 57-51-10 of the North Dakota Century Code, has determined the following gross production and oil extraction tax, penalty and interest due and payable for the period November 1979 through December, 1983.

	Tax	Penalty	Interest	Total
Gross Production Tax	$178,713.70	$23,614.22	$ 56,640.03	$258,967.95
Oil Extraction Tax	499,377.00	24,966.86	184,080.15	708,384.01

The total amount of the assessment, including penalty and interest, is $967,351.96. Interest has been computed through November 30, 1985. Additional interest at the rate of 1% per month or any portion of a month will accrue on unpaid tax. Any

payment toward the amount assessed should be accompanied by a copy of this Notice.

Schedules attached, constituting a part of this notice, explain in detail the reasons for each assessment and how the tax, penalty and interest was computed for each year. YOU WILL HAVE THIRTY DAYS FROM THE DATE OF THIS NOTICE TO FILE OBJECTIONS TO THE ADDITIONAL TAX AND TO APPLY FOR AN ADMINISTRATIVE HEARING. UNLESS SUCH OBJECTIONS ARE FILED AND AN ADMINISTRATIVE HEARING REQUESTED, THE ADDITIONAL TAX SHALL BECOME FINALLY AND IRREVOCABLY FIXED.

This assessment is based on an audit of the Teddy Roosevelt (T.R.) Gas Plant in Billings County, North Dakota for the period dated above. Through the audit process, it became apparent that substantial volumes of condensate had been recovered by the plant, but that, for tax purposes, this condensate had been incorrectly reported as a processed gas component.

Condensate is considered by the Department to be oil regardless of the point at which the condensate is recovered. This includes, but is not limited to condensate recovered at lease sites, compressor stations and processing plants. Pursuant to North Dakota statutes, therefore both the gross production tax rate (5%) and the oil extraction tax rate (6½%) are applied to the full (100%) gross value of the condensate.

In determining the tax due, no tax exempt (i.e. royalty) interests have been allowed. The assumption is that, if the value of the condensate has not been reported correctly as oil for tax purposes, it also has not been treated as oil for purposes of disbursement to interest owners. The Department will allow such exemptions if supporting documents are submitted to show that royalties actually were paid on the entire value.

This assessment should not be construed as all inclusive for the period noted. To date, gross production tax on gas processed at the T.R. Plant has been remitted on only a portion of the

tailgate value received for gas products sold (per contractual agreements with producers). The reasonableness of using this method to determine the gross value of gas continues under review and the results of the review could indicate further adjustments to the gross production tax due for the period.

Any statement of objections should be executed in duplicate and contain the following information:

1. Schedule of items to which you object, and grounds upon which you rely in connection with each objection.
2. Request for an administrative hearing.
3. Signature of person preparing objection.

Your statement of objections should be directed to:

Robert R. Kessel, CPA, CMA
Director of Income & Oil Taxes Division

Kent Conrad
TAX COMMISSIONER

Mary Stoller Loftsgard, CPA
Oil and Gas Tax Auditor
Phone (701)224-3654

MSL: js
88-89
J1-2

Part L

ADMINISTRATIVE HEARING BEFORE THE NORTH DAKOTA STATE TAX COMMISSIONER STATE CAPITOL BISMARCK, NORTH DAKOTA 58505

In the Matter of Notice of Determination dated October 18, 1985, Against Ecological Engineering Systems, Inc., General Partner, Western Gas Processors, Ltd.	AMENDED ADMINISTRATIVE COMPLAINT, OBJECTIONS AND REQUEST FOR FORMAL HEARING

COMES NOW the Petitioner, Western Gas Processors, Ltd. ("Western"), and for its complaint and objections states as follows:

1.

Western is a Colorado limited partnership authorized to do business in the State of North Dakota and whose sole general partner is Ecological Engineering Systems, Inc. ("EES").

2.

Western is part owner of the Teddy Roosevelt Gas Plant ("the Plant") located in Billings County, North Dakota.

3.

The Plant is a gas processing facility which purchases and processes wet gas and has been in operation since November of 1979.

4.

Western purchases gas for processing at the Plant from various producers operating in the Williston Basin in North Dakota.

5.

None of the producers from whom Western purchases gas are owners of the Plant.

6.

The gas is purchased at the wellhead at which point title transfers to Western.

7.

Western purchases gas from said producers pursuant to arm's-length agreements which set forth the price received by the producers for the gas.

8.

The price received by the producers for the gas accurately reflects the gross value of the gas at the well.

9.

Section 57-51-02, North Dakota Century Code, assesses a 5% severance tax on the activity of extracting oil and/or gas. The tax is levied on the gross value of oil or gas at the well. Pursuant to Section 57-51-05(4), North Dakota Century Code, gross value at the well is the price received by the producer unless said price is not the prevailing price in the field for oil or gas of the same vintage, character, kind and quality, in which event the Commissioner may assess tax based on the "prevailing price then being

paid at the time of production thereof in said field for oil or gas of like kind, quality and charter."

10.

The producers from whom Western purchases gas report and file Gross Production Tax ("GPT") returns as required pursuant to Chapter 57-51, North Dakota Century Code. Said producers pay GPT based on the price Western pays the producers for the gas.

11.

Under applicable gas contracts, Western pays said producers 60% of the net proceeds (for the purposes of this pleading, net proceeds shall be defined as set forth in the gas purchase contracts, an example of which has been previously furnished to the Commissioner) Western receives for liquids extracted from the gas sold by the producers to the Plant.

12.

The 60% of the net proceeds received by said producers is the gross value at the well for the gas sold by the producers to Western.

13.

The Commissioner has issued a Notice of Determination ("the Assessment") dated October 18, 1985, against Western for additional GPT, penalties and interest in the amount of $258,967.95 for the audit period November 1979 through December 1983.

14.

The Assessment assesses, in part, additional GPT allegedly owed on Plant and field condensate.

15.

Contain liquid hydrocarbons extracted from the gas stream are known as condensate. The condensate in this instance is extracted from the gas stream *off the lease premises* either through a gathering system ("field condensate") or through initial plant processing ("Plant condensate").

16.

The Plant and field condensate extracted from the gas sold to Western by the producers does not have the same chemical composition as crude oil.

17.

Pursuant to its gas contracts with the producers, Western retains 40% of the net proceeds received by the Plant from the sale of liquid hydrocarbons (condensate) extracted from the gas. Said 40% is retained as Plant profit and to cover such Plant costs as processing the gas. Said 40% of the net proceeds bears no relationship to the gross value at the well of gas sold to the Plant.

18.

By his Assessment, the Commissioner seeks to collect additional GPT based on the 40% of the net proceeds retained by the Plant despite the fact that the producers have paid GPT based on 60% of the net proceeds paid for the gas, that is, the gross value of the gas *at the well.*

19.

The Commissioner bases his Assessment on the proceeds received by the Plant from sales of condensate at the tailgate of the Plant ("tailgate value"). Such tailgate value has been enhanced as a result of such income producing activities undertaken by the Plant as gathering, treating, and processing. Thus, tailgate value does not reflect gross value *at the well*. By seeking to assess additional GPT based on the 40% of the net proceeds, the Commissioner is taxing the tailgate value of the gas or condensate, not the wellhead value, in violation of Section 57-51-02, North Dakota Century Code.

20.

Further, by premising his Assessment on tailgate value, the Commissioner violates the terms and provisions of Section 57-51-05(4), North Dakota Century Code, which requires tax to be paid on the price received by the producer for the gas at the wellhead pursuant to an arm's length agreement.

21.

In assessing additional GPT based on tailgate value, the Commissioner does not allow any deduction for plant costs, including, but not limited to, processing and gathering costs and a reasonable rate of return on plant investment.

22.

Any GPT owing to the State of North Dakota has been paid in full by the producers of the gas subject to the Assessment. The Commissioner has no power and authority to audit the Plant and assess GPT against Western.

23.

Section 57-51.1-02, North Dakota Century Code, imposes a 6½% severance tax ("oil extraction tax," hereafter "OET") on the activity of extracting oil. The tax is levied on the *gross value at the well of the oil extracted*. Gross value at the well is the price paid a producer for any oil purchased.

24.

For purposes of the OET, Section 57-51.1-01(2), North Dakota Century Code, defines oil as "petroleum, crude oil, mineral oil, casinghead gasoline, and all liquid hydrocarbons that are recovered from gas *on the lease incidental to the production of gas*." (Emphasis added.)

25.

Pursuant to Sections 57-51.1-02 and 57-51.1-01(2), North Dakota Century Code, OET is not levied on condensate recovered *off the lease*.

26.

In his Assessment, the Commissioner seeks OET on Plant and field condensate, together with penalties and interest in the amount of $708,384.01 for the audit period November 1979 through December 1983.

27.

Said plant and field condensate is recovered *off the lease premises* and is therefore expressly not subject to OET.

28.

In his Assessment, the Commissioner has assessed OET based on 100% of the proceeds received by the Plant from the sale of such condensate at the tailgate of the Plant ("tailgate value"). Section 57-51.1-02, North Dakota Century Code, requires, if applicable, OET to be assessed on gross value or the oil at the well. For the reasons set forth in paragraphs 1 through 23 above, the Commissioner's method of determining value for OET purposes is unlawful and violates the express terms and provisions of Sections 57-51.1-02 and 57-51.1-05, North Dakota Century Code.

29.

Assuming, *arquendo*, that the Commissioner's method of valuation for OET and GPT is correct, and further, that OET is applicable, the Assessment of OET and GPT is invalid for the following reasons:

a. In calculating Plant-wise value for Plant and field condensate based on tailgate receipts, the Commissioner has used estimated values rather than actual values despite the fact the necessary information was made available to the Commissioner to calculate tailgate value;

b. The Assessment includes several errors; for example, the figures for Plant-wise value are in many instances inaccurate, and the Commissioner has in at least once instance failed to deduct Windfall Profits Tax payments from tailgate value;

c. In calculating values attributable to Tenneco, Inc. ("Tenneco"), the Commissioner used estimated values rather than actual values despite the fact that the necessary information was available to the Commissioner;

d. The Commissioner has failed to recognize express exemptions set forth in Sections 57-51.1-01 and 57-51.1-03, North Dakota Century Code;

e. The Assessment against Western includes tax on gas which was not purchased by Western, but which was purchased from producers by a separate legal entity.

30.

The Assessment and the methods employed to calculate GPT and OET allegedly owing are contrary to established policies and directives of the Commissioner.

31.

Western and the producers have relied on said policies and directives.

32.

Western and the producers have followed and complied with said policies and directives, which compliance was accepted and approved by the Commissioner.

33.

The Commissioner is estopped from and has waived any right to issue and enforce the Assessment.

34.

The Assessment reflects policy changes in direct conflict with past directives, policies, practices and official pronouncements of the Commissioner.

35.

Said policy changes cannot be applied retroactively.

36.

The Commissioner has acted arbitrarily, capriciously and in abuse of his discretion by his consistent failure to adopt proper rules and regulations and retroactive application of newly formed policies.

37.

The Commissioner has exceeded his legislatively granted authority and is acting without jurisdiction.

38.

Western objects to the Commissioner's assertion of jurisdiction of this case and files this complaint and objection in order to protect and preserve its administrative rights.

39.

Western expressly does not elect any remedy to the exclusion of other remedies and reserves all rights to resort to any and all other remedies available to Western.

40.

Although Western believes that the clear and unambiguous language of the OET supports its position, if the Commissioner's interpretation of the OET is adopted, Western asserts that the OET is unconstitutionally vague and therefore void.

41.

Although Western believes that the clear and unambiguous language of the GPT supports its position, if the Commissioner's interpretation of the GPT is adopted, Western asserts that the GPT is unconstitutionally vague and therefore void.

42.

Western assets that under the GPT Western has no liability for these taxes, as the liability stated in the statute is that of the producer.

43.

Western assets that under the OET Western has no liability for these taxes, as the liability stated in the statute is that of the producer.

44.

Although Western believes that the GPT statute is clear and unambiguous, if the Commissioner's interpretation of who is liable for the taxes under the GPT is adopted, Western asserts that the GPT is unconstitutionally vague and therefore void.

45.

Although Western believes that the OET statute is clear and unambiguous, if the Commissioner's interpretation of who is liable for the taxes under the OET is adopted, Western asserts that the OET is unconstitutionally vague and therefore void.

WHEREFORE, Western prays that the Commissioner's Assessment be declared invalid and that a formal hearing be held with respect to those matters set forth herein, as well as such other matters as may hereafter arise.

Dated this 24th day of October, 1990.

McGLOIN, DAVENPORT,
SEVERSON AND SNOW
Professional Corporation

By _____

Gary C. Davenport, #5211
140 East 19th Avenue, Suite 400
Denver, Colorado 80203
(303) 863-9800

John W. Morrison, Jr.
FLECK, MATHER, STRUTZ &
MAYER, LTD.
400 East Broadway, Suite 600
Post Office Box 2798
Bismarck, North Dakota 58502
(701) 223-6585

ATTORNEYS FOR WESTERN
GAS PROCESSORS, LTD.

Part M

STATE OF NORTH DAKOTA
COUNTY OF BURLEIGH

IN DISTRICT COURT
SOUTH CENTRAL JUDICIAL DISTRICT

Western Gas Resources, Inc., formerly known as Western Gas Processors, Ltd., *Plaintiffs,* vs. M. K. Heidi Heitkamp, Tax Commissioner of the State of North Dakota, *Defendant.*	NOTICE OF APPEAL AND SPECIFICATIONS OF ERROR Civil No.

Notice is hereby given that Western Gas Resources, Inc., formerly known as Western Gas Processors, Ltd. (hereinafter "Western"), appeal from the order of the North Dakota Tax Commissioner ("Commissioner") dated May 22, 1991.

For its specifications of error, the Plaintiff/Appellant states as follows:

1. Certain of the findings of fact made by the Commissioner are not supported by a preponderance of the evidence. Specifically, such findings include, but are not limited to, the following:

   a. A finding that the processing facility constitutes the plant to the exclusion of the entire gathering system.

   b. A finding that field condensate is not a refined, processed product recovered at the gas plant.

   c. A finding that it is field practice to classify liquid hydrocarbons by where they are recovered, and it is industry practice to treat condensate distinctly as both

plant condensate and field condensate and to eventually, treat condensate as crude oil as a result of what happens to the condensate once it is recovered.

d. A finding that the chemical composition of condensate is identical to casinghead gasoline and is virtually the same as a "light" crude oil.

e. A finding that field condensate is petroleum and that it is also crude oil and casinghead gasoline.

f. A finding that field condensate falls within the definition of oil under the Oil Extraction Tax statutes ("OET") and therefore, pursuant to the provisions of North Dakota Century Code § 57-51.1, Western must pay the tax and is now liable for the tax.

2. Certain of the conclusions of law made by the Commissioner are not supported by the findings of fact. Such conclusions include but are not limited to the following:

a. That field condensate at issue in this matter is by the greater weight of evidence casinghead gasoline, crude oil or petroleum as those terms are used in North Dakota Century Code § 57-51.1-01(3).

b. That because field condensate is a part of the oil extracted, the field condensate is subject to the tax imposed to Section 57-51.1-02.

c. That Western is, therefore, liable to pay the OET owed by the producer (owner, including any royalty owner) of the oil, including field condensate it recovers, even though it is not actually involved in the extraction of oil from the earth.

d. That good cause exists for only abating 20% of the interest in this case.

e. That the 1981 Legislature intended the phrase "on the lease" as contained in North Dakota Century Code § 57-51.1-01(3) to mean that refined products

recovered at the gas plant are excluded from the OET provided for in North Dakota Century Code § 57-51.1.

3. The Commissioner's order is not in accordance with the law of North Dakota in the following respects:

a. The Commissioner's order that Western is liable for OET due on field condensate it recovered from a gas stream enroute to its Teddy Roosevelt Gas Plant for the time period from January 1981 through December 1983 is not in accordance with the laws of the State of North Dakota or the Commissioner's own interpretation of the laws of the State of North Dakota.

b. The Commissioner's interpretation of the OET to the effect that "on the lease" refers to the inlet of the processing facility is not in accordance with the preponderance of the evidence, the legislative history and the laws of the State of North Dakota.

4. In this case, deference should not be afforded the Commissioner's interpretation of the OET, since such interpretation violates the basic constitutional safeguards, including, but not limited to, due process, which Western is entitled to pursuant to the United States and North Dakota Constitutions.

5. The Plaintiff/Appeliant herein has not been afforded a fair hearing as required by the due process clause of the North Dakota and United States Constitutions and the provisions of Section 28-32 of the North Dakota Century Code.

6. The constitutional rights of the Plaintiff/Appellant have been violated by the Commissioner's arbitrary, capricious and unreasonable actions in this matter, in regard to the Commissioner's interpretation of the OET and imposition of the tax including penalties and interest on Western.

7. The OET as interpreted by the Commissioner is unconstitutional for vagueness and unenforceable against Western. The rights of the Plaintiff/Appellant so violated

include, but are not limited to, a denial of due process as required by the United States and the North Dakota Constitutions.

8. The Commissioner's actions throughout this matter, including her ultimate arbitrary, capricious and unreasonable decision in this matter, have been without substantial justification, thereby entitling Western to recover reasonable attorneys' fees and costs pursuant to the provisions of Section 28-32-21.1 of the North Dakota Century Code.

Dated this 20th day of June, 1991.

McGLOIN, DAVENPORT,
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By _____
Gary C. Davenport

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By _____
John W. Morrison

ATTORNEYS FOR THE
TAXPAYER

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing document was on the 21st day of June, 1991, served on the following by placing said copies in the United States first class mail, postage prepaid, addressed as follows:

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_____

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Part N

STATE OF NORTH DAKOTA
COUNTY OF BURLEIGH

IN DISTRICT COURT
SOUTH CENTRAL JUDICIAL DISTRICT

Western Gas Resources, Inc., successor in interest to Western Gas Processors, Ltd., *Plaintiff-Appellant,* vs. M. K. Heidi Heitkamp, Tax Commissioner of the State of North Dakota, *Defendant-Appellee.*	NOTICE OF APPEAL Civil No. 91-C-1538

PLEASE TAKE NOTICE that the Plaintiff-Appellant, Western Gas Resources, Inc., successor in interest to Western Gas Processors, Ltd., hereby appeals to the North Dakota Supreme Court from the Judgment entered in the above entitled case on November 25, 1991.

Dated this 22 day of January, 1992.

Gary C. Davenport
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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing document was on the 22 day of January, 1992, mailed to the following:

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JOHN W. MORRISON

Part O

TESTIMONY OF HUNTER HERRON[1]

Q. Now, what does "on the lease," as it relates to oil and gas terminology, mean to you?

A. Generally, the point where custody of the oil and gas transfers from the producer to the purchaser.

Q. All right. And that would be the meter at the lease generally; correct?

A. Yes. Certainly in the case here of the Teddy Roosevelt system, that would be the meter on the lease.

Q. If I understand — and I think it's pretty clear — "on the lease" is everything up to the custody transfer meter?

A. Yes.

Q. And everything beyond that point is "off the lease"?

A. Yes.

Q. Have you ever heard of any other definition whatsoever in regard to "on the lease"?

A. No, I guess not.

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[1] From Transcript of Hearing, page 371.

Part P

TESTIMONY OF ARLON TUSSING[1]

Q. Mr. Tussing, are you familiar with the concept in oil and gas taxation for production and extraction taxes of on the lease?

A. Yes.

Q. What's your understanding of that?

A. The term refers to the cost of operations that's undertaken — as deemed to be part of the production process, and thus, say, not deducted from the value for production tax or royalty purposes, it may include use of products in kind, as lease fuel, compressor fuel, as for injection, the use of gas, and those are — they are not treated separately or measured for the purpose of valuing the production from those.

Q. Did you say that the term refers to the cost of operations deemed to be part of the production process?

A. Yes.

Q. What do you mean by that, part of the production process?

A. That the value of oil or gas produced is measured after these expenses have been incurred. No credit is given for them in valuing the production from the lease.

Q. So it's all before there is any value added?

A. Yes.

Q. So your understanding of on the lease is it is when oil and gas is actually physically extracted from the ground before any value is added to it?

A. Yes, and if some of that product, for example, is reinjected to maintain reservoir pressure, or that production is not valued for the purpose of taxes or royalties, or if the price controls — applicable price controls.

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[1] From pages 99-100 of Deposition Transcript of Arlon R. Tussing made an exhibit to the Administrative Hearing Record.

Q.[2] Would condensate fit within the definition of liquid hydrocarbons?

A. Yes.

Q. How do you interpret the language or what does the language mean to you, I should say, in this sense when it says, on the lease?

A. With the reservation I indicated earlier that I know there are controversies as to the geographic extent of on the lease for purposes of such provisions, I would connect the terms on the lease with the place of recovery.

Q. And by the place of recovery, do you mean —

A. That is to say that oil in this case refers to those hydrocarbons whose recovery, whose liquid hydrocarbons whose recovery occur physically within the lease boundaries.

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[2] *Id.* at page 126.

Part Q

TESTIMONY OF DUKE ELLINGTON[1]

Q. (MR. DAVENPORT CONTINUING) Mr. Ellington, are you familiar, based upon your experience in the industry, with the general terminology "on the lease"? Have you heard that before?

A. Yes.

Q. Can you tell me, based on your background and experience in the industry, what that terminology means?

A. My understanding, based on my 32½ years in the business, is that that generally refers to the production function, that is, the activity of producing the well, drilling and operating the producing well, it includes the wellhead equipment, whether it be just the valving that's known as a Christmas tree, or in these cases they have pumping units on the wells, it also includes the separator at the lease, the heater treater and the stock tanks for the liquid and, if necessary, storage tanks for the water, and that the — those functions are the production functions or the lease functions.

Q. At what point does off — does it become off the lease?

A. As a general rule, in the case of the gas, it's when it passes through a custody transfer meter, at some point usually in the near proximity of the well or of a central separator battery in the case where a number of wells are collected through a central battery.

Q. Would it be accurate to say that anything before the meter would be on the lease and anything after the meter would be off the lease?

A. I think that's correct.

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[1] From Transcript of Hearing, pages 166-167.

Part R

TESTIMONY OF BILL M. SANDERSON[1]

Q. Mr. Sanderson, in your association with the oil and gas industry, are you familiar with the terminology "on the lease"?

A. Yes.

Q. Do you have an understanding, from your work in the industry — for how many years, approximately?

A. 30.

Q. — for 30 years, as to how the industry views the terminology "on the lease"?

A. Well, I think it's the activities that occur on the lease itself. I mean, I think that's the tank, battery, the pump, the equipment that is on the lease.

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[1] From transcript of hearing, page 50.

Q.[2] (MR. DAVENPORT CONTINUING) Does the issue of custody or ownership of the gas, itself, have any bearing on the definition of "on the lease"?

A. Well, I think when we take custody of that gas and put it into our system, then I consider that off the lease.

Q. You consider that off the lease?

A. Yes.

Q. So you consider it to be on the lease before the meter?

A. That's true.

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[2] *Id. at* page 51.